



STATE OF WASHINGTON

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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May 12, 1997

The Honorable John D. Dingell, Ranking Member  
Commerce Committee Democratic Office  
564 Ford House Office Building  
U.S. House of Representatives  
Washington, D.C. 20515

Subject: Survey Questions of April 10, 1997

Dear Congressman Dingell:

Thank you for the opportunity to respond to the survey questions about electricity industry restructuring which you included in your letter of April 10, 1997. Restructuring of the electricity industry is among the most complex public policy issues of the day. We are pleased that your survey questions demonstrate a thoughtful and thorough approach to the complicated issues restructuring will raise for federal and state policy makers.

We hope you find the following responses constructive and useful. We have also enclosed some recent correspondence between members of the Northwest Congressional Delegation and the Pacific Northwest Governors. Finally, several other brief documents are enclosed that we thought might find pertinent to the subject of your survey.

Questions concerning our responses can be directed to Dick Byers of our electricity policy staff (360-753-3006).

Sincerely,

    
Sharon L. Nelson      Richard Hemstad      William R. Gillis  
Chairman              Commissioner              Commissioner

cc: Washington Congressional delegation

enclosures:



Responses to April 10, 1997 Electricity Industry Survey

Washington Utilities and Transportation Commission

1. *Has your Commission or State Legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?*

Retail competition has not been generally adopted in Washington by statute or by Commission action. The Washington Legislature did consider bills ranging from directed studies to broad scale restructuring in its recently completed Session. No bills were adopted. The committees of jurisdiction plan to hold workshops and hearings over the interim on this issue.

The Commission has approved two retail competition pilot programs for Washington Water Power Company. The first applies only to large load customers. Nine of fifteen eligible customers are participating. Price savings have been in the range of 16%, but initial commodity energy sales made by the alternative suppliers are generally believed to be below market prices. The second pilot will provide access to residential and commercial customer classes. It is approved, but will not commence until later this year.

Generally, Washington is a low-cost electricity state. The average total cost of power underlying Washington's retail rates is in the range of 2 to 2.5 cents per kWh (some utilities a little higher, some a little lower). The market clearing price for power in the West is estimated by all analyses we have seen to settle in a range between 2.5 to 3.5 cents per kWh. Consequently, we are skeptical that there is room for retail competition to reduce significantly average electricity rates across Washington.

2. *Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?*

a. No

b. No

c. As a part of the implementation of recommendations from the Comprehensive Review of the Regional Energy System, the Governors of the four Northwest states have appointed a Transition Board. This Board and the Governors themselves have communicated with members of Congress from the

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Northwest about legislative action that may be necessary affecting the Bonneville Power Administration. The Board is using a regional process to develop legislative recommendations to forward to the Northwest congressional delegation. Correspondence between the delegation, the Governors, and the Transition Board is attached.

3. *Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?*

So long as a clearly established "link" in the electricity delivery chain remains in state jurisdiction, the Washington Utilities and Transportation Commission (WUTC) has the necessary authority to address any stranded cost issues affecting the investor-owned utilities in Washington. It may be necessary for Washington to address distribution system bypass more carefully to ensure that stranded cost payments cannot be evaded and shifted, but this is a matter that can be handled in state law.

Two-thirds of the retail electricity sales in Washington are made by public or consumer-owned utilities that are not under the jurisdiction of the WUTC. Stranded cost issues affecting these utilities would need to be addressed by local ordinance or state law. The Bonneville Power Administration, which supplies at wholesale roughly half of the power used in Washington also faces potential stranded cost problems (involving nuclear project debt, Treasury debt, and fish and wildlife program obligations on the Columbia River system). Neither the state legislature nor the WUTC can effectively address these BPA stranded cost issues.

4. *Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA), or the Public Utility Regulatory Policies Act of 1978 (PURPA)?*

Without details of how such federal legislation might be constructed, it is difficult to say for sure. But, we are not aware of any additional authority needed. As noted in the preceding question, the state's authority does not extend to key market structure and stranded cost issues affecting one of our principal power suppliers, the Bonneville Power Administration.

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5. *Would any Constitutional issues be raised by federal legislation:*

*a. Mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?*

*b. Requiring states to conduct a proceeding on retail competition reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?*

We offer no opinion on the Constitutional question. We would state that, if Congress is to choose between these two approaches, we strongly prefer the approach contemplated in option "b".

6. *From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?*

Washington has not adopted any definitive state action. If it were to do so a Congressional mandate that did not grandfather the state's action could be inconsistent with a competition framework developed to best serve Washington's consumers under Washington's specific circumstances. For example, Washington's electricity generation system is dominated by hydropower. Consequently, restructuring the electricity industry in Washington will require consideration of water resource related issues (e.g. irrigation, transportation, recreation, and others) that are intricately connected with electricity generation market issues.

7. *In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition was necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.*

*a. Are you aware of any study or analysis relevant to your State that supports this conclusion?*

*b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years?*

a. We are not aware of any study that supports the conclusion that mandating retail competition in Washington is the only or best way to protect the interests of small and residential consumers in the face of industrial rate discounts. In fact this conclusion appears on its face to represent a paradox. If industrial customers have the market power to negotiate better deals than smaller customers under regulation why would they have any less market power under open competition? At least under regulation protections can be afforded to smaller customers against cost-shifting resulting from such discounted deals. Under open competition there is no guarantee or reason to believe that less attractive or profitable loads will not bear a disproportionate share of infrastructure costs (i.e. suppliers may well compete aggressively for large volume loads and less aggressively for smaller volume loads).

While some large customers of utilities regulated by the WUTC have been granted discounted pricing, these customers have picked up the market risk associated with market prices. Moreover, shifting of risks and costs to other customers and customer classes has been protected against. All risks associated with such discounts are borne by shareholders unless and until the WUTC, in a future rate case, determines otherwise.

b. The following table tracks average industrial and residential rates in Washington for the years 1989 through 1995. The first section is a statewide average for all of Washington's 63 utilities. The second section represents an average for just those investor-owned utilities under WUTC jurisdiction. With respect to the question of subsidies we can only respond about the utilities under WUTC jurisdiction. For two of the three utilities, Puget Sound Energy, and Washington Water Power, cost-of-service studies demonstrate that both residential and industrial rates are below cost of service and commercial rates are above cost of service. For the third, Pacific Power and Light, the cost of service study is too dated to draw any strong conclusions. In its 1993 rate order establishing rates for Puget Sound Energy (then Puget Sound Power and Light) (Docket No. UE-929262), the WUTC took steps to bring rates into closer agreement with cost of service analyses. This increased both industrial and residential rates proportionally more than commercial class rates.

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TABLE 1:

Average for all WA Utilities (nominal cents/kWh)						
	1990	1991	1992	1993	1994	1995
resid.	4.4	4.4	4.5	4.7	4.9	4.9
indust.	2.4	2.3	2.2	2.5	2.8	2.9

Average for all WA IOUs (nominal cents/kWh)						
	1990	1991	1992	1993	1994	1995
resid.	5.2	5.2	5.2	5.4	5.6	5.7
indust.	3.5	3.6	3.7	3.9	4.2	4.3

source: US Energy Information Administration

8. *Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.*

The following table tracks average rates in Washington for the years 1990-1995 by customer class. The first section is in nominal dollars, the second in inflation adjusted dollars (1990\$). In nominal dollars electricity has increased in price by 11% (residential), 17% (commercial) and 21% (industrial) over the six year period. In inflation adjusted dollars, electricity prices have declined by 5% for residential uses, remained constant for commercial, and increased 4% for industrial.

TABLE 2:

WA Average Electricity Revenue by Class (nominal cents/kWh)						
	1990	1991	1992	1993	1994	1995
resid.	4.4	4.4	4.5	4.7	4.9	4.9
comm.	4.1	4.2	4.3	4.5	4.7	4.8
indust.	2.4	2.3	2.2	2.5	2.8	2.9

WA Average Electricity Revenue by Class (1990\$ cents/kWh)						
	1990	1991	1992	1993	1994	1995
resid.	4.4	4.2	4.2	4.3	4.3	4.2
comm.	4.1	4.0	4.0	4.1	4.1	4.1
indust.	2.4	2.2	2.0	2.3	2.5	2.5

source: US Energy Information Administration. Inflation=CPI

9. *Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders, or the highest bidder?*

As a low-cost state, we are very much concerned that a single market price for electricity will cause our prices to rise even as the price of power for higher-cost states declines. Shareholders might well reap the benefits of such a circumstance, while ratepayers see competition bring prices that are higher. Overall, open competition might bring down the average price of power (just as it has the average price of air travel), but some regions like ours could see an increase. If permitted by Congress to do so, states could capture the increased value of low-cost resources for distribution to ratepayers, who, after all, have been paying depreciation on these resources for as long as they have been in ratebase. Alternatively, states could -- again if not prohibited by Congress -- impose rate caps for default utility service to ensure that those customers who desired continued "cost-based" service from low-cost resource could have it.

Fundamentally, electricity is an essential public service. It is not generally or easily substitutable and therefore does not have all of the character of a commercial commodity. Where the public has granted usage rights to public resources (condemnation of land, licensing of hydropower, etc.) to monopolies to enhance the public's access to this service, the value of these resources should be captured by the public -- not the highest bidder.

10. *Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity" (that is, whether or not the state can bar sellers located in other states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?*

a. Washington has not adopted retail competition and so we have not addressed the issue of reciprocity in a general way. The Washington Water Power open access pilot program

mentioned in the response to question number one does include a reciprocity provision. This provision was approved by the WUTC.

b. It would appear to us that a reciprocity requirement imposed by a state adopting retail competition serves principally to benefit interests of owners of generation in the adopting state. It insulates "above market" generation by preventing competition from power imported from a non-adopting state. It advantages "low cost" power available for export from the adopting state by leveraging open markets of adjacent states. It may damage interests of consumers in the adopting state by limiting the generation supply market available to them to imports from adopting states only.

c. If market-priced power imported into a state causes that state's utilities to suffer stranded capacity costs, the interests of shareholders (cost recovery) and customers (no cost shifting) can be addressed through a stranded-cost policy which balances consumer and shareholder interests. The wholesale market is also available to mitigate these costs. Consequently, a reciprocity requirement is not necessary for a state to protect shareholder and customer interests.

We also note that a state which has not adopted retail competition, and which exports competitively priced power to an adopting state, is probably able to do so because its fixed generation costs are being recovered from captive customers. This does not diverge significantly from the current situation of wholesale power competition. The wholesale market has always been based on marginal operating costs. Capital costs for capacity have, for the most part, been recovered from core retail customer base. This has benefited the core customers so long as revenue from these transactions was credited against core rates. In the circumstance of export to the retail market in another state, transactions may or may not be beneficial to captive customers, depending on whether these customers share in the proceeds of the sales in a similar manner.

11. *If Congress were to require "unbundling" of local distribution company services as a part of a retail competition mandate, what practical problems might this present to state regulators?*

This is a difficult question to answer in the abstract. The answer will depend on the nature of the competition mandate. Here are some issues we anticipate would arise. None are insurmountable, but all would involve significant practical



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problems. As states pursue their own approaches to reform of retail electricity industries and regulations, they will face unbundling issues. If states are permitted to fashion their own policies, the resolution of these issues will vary depending on the particular reforms each state chooses to implement.

First, the FERC has established that, if a state chooses to unbundle, the FERC will grant some deference to the state's determination of a dividing line between state jurisdictional distribution services and federal jurisdictional transmission services. However, this dividing line remains ill-defined and illusive. If Congress were to impose unbundling without drawing this line clearly, controversy will certainly ensue regarding what services are included in what bundles. If Congress endeavored to define the bundles, it would need to address the fact that significant differences in state and regional grids exist across the U.S. Alternatively, Congress could leave these definitions up to the states along with the necessary clear authority. In either event, states would have to maintain clear jurisdiction over some "link" in the delivery system in order to exercise authority over retail stranded cost recovery, revenue collection for universal service and resource programs, and local reliability, metering, and accounting standards. Traditional definitions of transmission and distribution would need careful examination and most likely revision because some customer classes are not currently allocated any traditional distribution costs since they take power at transmission voltages. Without a component of distribution over which the state maintains some authority, these customer classes might escape mechanisms used by state policy makers to accomplish stranded cost and other electricity service policies.

Second, if unbundling were mandated as part of an "open access" approach to distribution services, the range of choices available to states for introduction of competition as a tool to benefit consumers would be significantly limited. "Open access" distribution is only one way consumer driven competition could be brought to electricity. Alternatives might involve the distribution company acting as a buying agent for consumers -- through individual transactions, mandated sales into and purchases from a pool, or through the assemblage of various resource portfolios. By mandating unbundling to accomplish an open access approach Congress would significantly limit state options in fashioning electricity restructuring to meet individual state circumstances and consumer preferences. Moreover, the "open access" distribution approach may well pose significant physical and accounting system management and

implementation problems for the states (e.g. see the enclosed material regarding information systems necessary to schedule, manage, meter, and account for hundreds of thousands of individual transactions on a network that is not individually switched).

Third, unbundling of services implies that separate services will be separately priced. This raises the question of whether Congress or the states should determine which services should be unbundled and whether Congress or the states should establish the pricing principles to be applied -- embedded, marginal, replacement, market, etc. A Congressional prescription might not be sufficiently flexible to accommodate specific state circumstances, needs, or policies.

Finally, a federally mandated unbundling would almost certainly invite retail utilities to choose federal court or other federal venues to argue for recovery of retail stranded costs caused by the federal mandate. This would likely undermine, or at least significantly complicate, state efforts to deal with stranded costs in ways that recognize specific state circumstances.

12. *Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?*

Yes.

Some of these issues were introduced in the answers to question two and three. Half of the generation and four fifths of the transmission serving Washington is federal. Federal generation uses falling water of the Columbia and Snake Rivers as a fuel source. These water projects are also a crucial resource for transportation, irrigation, fish and wildlife, tribal heritage and flood control. No fully competitive wholesale power market (let alone retail power market) can be established in the Northwest without careful attention to the dominant role of BPA and to the multiple resource imperatives of the Columbia River system. Federal transmission and generation will be difficult to separate to establish a fully open access transmission system until debt (Treasury and nuclear) and environmental responsibilities are identified and apportioned between the transmission and generation function. Without this clarity, BPA will be forced to either exert market power (through transmission access) to ensure needed revenues are secured, or permit these obligations to be "stranded" on either the federal government or regional customers it can hold as captive.

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Neither of these outcomes are desirable. Congress is the only body that can provide a clear resolution to this problem.

In order to ensure that the wholesale power market is enhanced and not distorted by BPA's generation and transmission dominance, we recommend that its tariffs and products be placed fully under the jurisdiction of the FERC.

In whatever manner resolution of the separation of federal generation and transmission interests is achieved, we do not believe that BPA should become "just another retail marketer". There are an abundance of private and public firms ready and able to compete in the retail electricity markets of the Northwest. BPA, as a federal agency, can and should add more to the power system and the regions's resource management than simple commercial power operations. We believe it can; but if not, it should be privatized. We believe BPA's role in marketing the power generated from the multiple use projects should be to bridge the gap between power markets and river operations to harmonize power and other resource values. Moreover, because the Columbia is an international resource, the management of the river system must also involve coordination with Canadian national interests. It would be difficult, if not impossible, to accomplish the multiple objectives required of river management if power operations were transferred to private commercial hands. Finally, as the embodiment of federal energy (and related environmental) policy in the Northwest, BPA can lead by example both in energy conservation and renewable resource development, and in environmental stewardship.

In a competitive wholesale (and possibly retail) market, BPA should no longer be expected or required to be the central resource developer to meet all power requirements of the region. This responsibility (arising from the 1980 Pacific Northwest Electric Power and Conservation Act) should be eliminated.

This question also covers public utilities of local jurisdictions. The Northwest has a rich history of locally-controlled, publicly-owned, utilities. Again, two-thirds of electricity service in Washington is provided by such utilities. At the state level, Washington does not grant exclusive, geographic service territory franchises. Service territory competition has existed in our state for more than 60 years and has served us well. We would not point to any problem that exists between Washington's public and private utilities that would require federal action to fix. We would note, however, that if either Congress or the state

requires that utility facilities financed with "public use" tax exemptions be dedicated to open access "private use" that the tax status of the financing instruments be clarified.

13. *How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?*

The WUTC is funded through a dedicated fund supported by a capped fee assessed on the gross operating revenues of jurisdictional companies. If a major portion of the revenue generated by retail electricity sales is deregulated, the application of this fee is made a question. This is troubling because the work required to transition to a fully competitive market is significant -- perhaps for a time more intensive than that required to regulate prices. This is a clear lesson of the restructuring of the telephone industry. So the answer to the first part of your question is, funding needs would be unlikely to go down and might actually increase. We can only speculate in answer to the second part of your question. This would be a matter for the state legislature and we trust it would recognize the work necessary and make available an appropriate level of resources.

14. *Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?*

We have not adopted any plans to use this approach for the recovery of assets stranded due to retail service industry restructure. Pursuant to state law enacted in 1993, we did approve securitization of conservation expenditures of one of Washington's investor-owned utilities. This involved securitization of a known level of regulatory asset and a known schedule of amortization in rates. The approaches we have heard described for securitizing stranded generation assets appear to involve issuance of bonds based on an estimate of over market power costs. Securitizing a cash flow based on such an estimate appears to us to shift substantial risk to consumers. If fuel projections turn out to be too low (stranded costs are estimated too high) consumers could be left to pay off the security even while they face higher power costs. It would appear to us that this is a very risky strategy only likely to be in the consumer's interest if fuel and power costs remain at or below the basis in the stranded cost estimate.

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15. *There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.*

*a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?*

*b. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what conditions?*

*c. Should Congress enact legislation to modify the holding in Ohio Power Co. v FERC, 954 F.2nd 779 (D.C. Cir. 1992)?*

No Registered Holding Companies currently operate in Washington. From our perspective, we see no reason to believe that effective competition necessarily requires the repeal of PUHCA. However, we understand that other parts of the country face different conditions. We expect that Congress will likely act to address these regional conditions, just as we would hope Congress would tailor its actions to respect and address the important aspects of the Northwest region's electricity market conditions.

With respect to PUHCA reform, we support the recommendations and suggestions made by the National Association of Regulatory Utility Commissioners.